
Officials targeting companies in unemployment tax fraud

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The state of California is cracking down on companies that evade or underpay unemployment taxes.

Tax officials are using new state and federal laws to assess \$159 million in unpaid unemployment taxes from 40 employers in the past two years. So far, the state has collected more than \$77.5 million in settlements; many of the larger assessments are caught up require in administrative appeals.

The crackdown comes at a time when the once-isolated problem of unemployment fraud has mushroomed into nationwide schemes involving the setting up of shell companies, "selling" employees to employee leasing firms that handle payroll functions and shuffling of unemployment tax rates.

Large accounting firms and employee leasing firms have actively marketed such plans-whose legality is a subject of debate--as a way for employers to cut back on costs.

California and other states claim they are losing out on hundreds of millions of dollars a year in uncollected taxes, shrinking the amount of funds available to pay benefits to laid-off workers.

The problem spurred Congress to pass a law last year that makes it easier for states to find scofflaws. California, along with Michigan, North Carolina, Connecticut and New Jersey, are among the states that are aggressive in going after tax payments.

"Employers who engage in tax manipulation schemes ... unfairly shift their costs to other employers," said Suzanne Schroeder, spokeswoman for the state Employment Development Department. "This hurts everyone: employers, employees and taxpayers who must make up the difference."

Handshake debate

With an improving economy and fewer claims filed, California's unemployment trust fund has stabilized since nearly falling into bankruptcy two years ago. But the statewide crackdown was set in motion then, when officials vowed to go after employers and employees.

Since the settlements are private, there is little public information on which employers the state has targeted.

Details of just one case, involving an employee-leasing firm, have been made public in the state because the company filed suit to fight a \$20 million assessment.

EDD officials audited the books of American Employers Group Inc., an Omaha, Neb.-based subsidiary of San Francisco-based Applied Underwriters Inc. in June 2003, at the height of the employment trust fund crisis.

American Employers Group is a professional employee organization--an employee leasing company that specializes in providing payroll services, workers' compensation coverage and other human-relations services for employers.

PEOs take on hundreds or even thousands of clients, counting on their size to reduce labor costs for their employer customers. Investigators in several states allege they also skirt workers' compensation laws and allow employers to claim lower workers' compensation, unemployment and other payroll rates for their own records.

According to court documents filed by American Employers Group in Los Angeles Superior Court, the employee leasing firm paid \$8.2 million in unemployment insurance taxes for the years 2001 through 2003.

But state auditors found that American Employers Group engaged in systematic "underpayment of quarterly premiums" totaling \$12.1 million over that same period. Add in \$8.2 million in penalties and interest and the bill, by the state's count, totaled \$20.4 million.

In its court filings, American Employers Group claims that EDD officials made a verbal agreement to settle the case for \$4.4 million. The company later sent a check, but it was returned.

In court filings, EDD officials say there was no written settlement agreement, and that American Employers Group concocted the story to get out of paying its full bill. The case is still in discovery.

Schroeder declined to comment on the case while it's being litigated. John Poison, an attorney representing American Employers Group, also declined to comment.

Promoting techniques

Laws that prohibit releasing the names of the companies settling claims make it harder to assess the identities of the organizations involved. But it appears that employee staffing firms and accounting firms are at the forefront.

One company, a subsidiary of Philadelphia-based Aramark Corp., was identified in Congressional testimony this year, after it agreed to pay \$2.4 million in Michigan for allegedly merging the employees of eight businesses into one with a lower tax rate. (In settling, Aramark did not admit the charges.)

David Plawecki, deputy director of the Michigan Department of Labor & Economic Growth, said in a prepared statement that what Aramark was alleged to have done is part of an emerging pattern of companies trying to game the system.

"The basic idea is to transfer payroll out of an existing company or organization to a new or different organization solely or primarily for the purpose of reducing unemployment taxes," Plawecki said.

Last year, several small companies in North Carolina reached settlements on claims the state said they owed. One of those, a temporary staffing firm, said the idea of restructuring to lower unemployment taxes came from one of the Big Four accounting firms, Deloitte & Touche. It declined the offer but pursued a similar plan with its existing accountant, Ernst & Young.

State regulators said the program was illegal and initially assessed the firm for more than \$1 million in back unemployment insurance taxes. The company settled for \$700,000 after the state dropped interest and penalties from the assessment.

In Congressional testimony, a top executive with Kelly Services Inc., the Troy, Mich.-based temporary staffing agency, said competitors routinely avoided paying

full unemployment insurance taxes. Carl Camden, president and chief executive of Kelly Services, said his firm had been approached by major accounting firms offering to save the company up to \$26 million in taxes by adopting one or another of these schemes, which he said the company declined to do.

"Promoters have been imaginative and will continue to figure out creative techniques," he said, adding that more than a dozen existed.

There are fears among employers that enforcement efforts will go too far and deprive them of a way to save money.

The California Chamber of Commerce opposed a bill last year cracking down on scofflaws. That bill, AB 664 by Assemblyman (now state Sen.) Alan Lowenthal, D-Long Beach, became law.

"We were concerned because there are very legitimate reasons for mergers and acquisitions that are not done expressly to lower unemployment insurance taxes and some of those companies could find themselves caught up in this," said Julie Broyles, the chamber's lobbyist on the issue. She said the chamber also believed the penalties stipulated in the law were too high.

"The key is to go after the companies who are intentionally gaming the system, not those who made an inadvertent mistake or who are using the current tax code to their benefit," Broyles said.

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